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Assessing the Costs and Benefits of “Punishing Russia”

[caption id="attachment_8993" align="alignleft" width="300"] Source: Severin Nowacki[/caption]

With the referendum on Crimean independence and possible reunification with Russia now taking place, the US and its European allies have threatened punitive actions to punish Moscow. These measures include the denial of visas, freezing of assets, even possibly commencing economic sanctions against Russia and Russian interests. Such escalation of tensions would undoubtedly have negative, potentially disastrous, effects on the European and global economy, not to mention the all-important political and diplomatic ties between West and East.

On Saturday March 15th, the day before this historic referendum in Crimea, the Washington Post, famously regarded as a principal mouthpiece of the US political establishment, published a strongly worded Op-Ed piece collectively written by the Editorial Board entitled [US, EU must stay the course on Russian sanctions over Ukraine](#). The article laid out a number of punitive actions that the West should, according to the authors, use to punish Russia, including targeted sanctions against prominent Russians in Putin’s inner circle.

Specifically, the authors suggest the denial of visas and freezing of assets of such key Russian figures as Igor Sechin (Chairman of Rosneft), Vladimir Yakunin (President of Russian Railways), and Alexei Miller (Chairman of Gazprom). Such measures must, according to the authors, be combined with “punishment” of Russia diplomatically including exclusion from the G8 and Organization for Economic Cooperation and Development (OECD). Were the US and EU to follow through with these and other sanctions, they would undoubtedly open the door for an effective Russian response - a response that would have dire consequences for the already fragile economic situation in Europe and the US.

Sanctions and Russia’s Counter-Moves

There are many both in the West and Russia who believe that the suggestion of punitive actions from the US and EU are merely empty threats. However, it is critical to examine just how Moscow might respond to such provocative measures, as sanctions would undoubtedly be seen as a very serious escalation. Moreover, it is essential to consider how the Russian response would impact the entire world.

First and foremost is the fact that Russia holds the key to Europe’s energy future. With Russia providing more than one third of Europe’s gas imports, any sanctions could immediately lead Russia to scale back, or even more drastically, cut off the gas to Europe. This would create innumerable problems for Europe, particularly for the export-dependent economy of Germany, which is unquestionably the economic powerhouse on the continent. With German technology, luxury cars, and the like no longer being produced in the required numbers, the economy would, almost overnight, come to a screeching halt. Moreover, future German energy security would be threatened, as the primary lifeline for the country is the Russian Nord Stream pipeline, which brings Russian gas across the Baltic and into northern Germany.

Additionally, such a scenario would create a tremendous amount of political discord within the EU as countries traditionally friendly with Russia, such as Italy, also heavily reliant on Russian energy, become ever more disenchanted with the belligerent policies of Brussels vis-à-vis Russia and Ukraine. With turmoil already in high gear in Italy, Spain, Portugal, Greece and many other economically devastated countries in Southern Europe, it is unlikely that the political will to go along with a suicidal sanctions regime will remain.

Russia also has a tremendous financial weapon that could be unleashed against the US and EU: their dollar holdings. With the Russian government, not to mention private Russian holdings, retaining a tremendous amount of US dollars, they could easily choose to transfer or dump their dollars and create a veritable panic on Wall St and in Washington. In fact, this scenario may have already taken place on a small scale.

As [CNBC reported](#) last week, the Russian Central Bank may have quietly transferred a portion of its dollar holdings offshore. More than \$106 billion of US securities held by foreign central banks were suddenly transferred away from the US Federal Reserve, with the majority of the securities being US Treasury bonds. It remains unclear exactly which central bank made the transfer, though there is a good deal of speculation that it was Russia. Though the move was not enough to severely rattle markets, it has been interpreted as a warning to Washington and Wall St. from Moscow that the Russians are willing to retaliate in the case of economic war being waged against them.

Naturally, the danger to the US is not simply Russian holdings of dollar assets that could be dumped, but the flight out of the dollar that such dumping could trigger. With China and other powerful economies heavily leveraged in dollars themselves, their central banks could become concerned for their own investments and might cautiously begin to move out of the dollar themselves, triggering a chain reaction that would prove devastating for the US currency and economy more generally.

Aside from purely economic counter-measures, Russia has a number of political and strategic moves it could make to retaliate against possible sanctions. Principally, Moscow could begin to act with more impunity in theaters of conflict. In Syria, Russia could move from being a backroom supporter of the Assad government, to being a principal supplier and backer. Russia could finally deliver the weapons systems that they have, to this point, been reluctant to hand over to Damascus, including more modern anti-missile systems, fighter jets, and other critical military supplies. In Iran, Russia could cease its obstinacy with regard to delivering advanced weapons systems, choosing instead to buttress Iranian military power as a check to US pressure.

Sanctions: A Positive Force for Russia?

Although there are, undoubtedly, costs for Russia associated with the possibility of sanctions, it is equally possible to view such measures as beneficial for Russian power in the long term as they might motivate Russia to settle outstanding disputes and move toward expanding its global influence. In this way, sanctions might very well be that external force that promotes Russia's geopolitical, economic and strategic development.

For instance, the possibility of European sanctions on Russian energy could be the push necessary for Russia to finally resolve its pricing disputes with China and officially make progress on Sino-Russian energy trade. As the [Financial Times reported](#) back in January, Russian energy giant Gazprom is very close to finally sealing an agreement with China regarding gas pricing. Once the agreement is official, Gazprom would then begin the major investment required to develop the critical pipelines and other aspects of the energy delivery infrastructure required to finally achieve the long sought dream of a viable Sino-Russian energy relationship. Were the EU sanctions actually implemented, Russia would be all the more motivated to overcome whatever obstacles remain and thereby transform their economic and geopolitical calculus immeasurably.

Not only would this provide Moscow with still more motivation to work closely with Beijing, it would transform Russia's relations with the former Soviet Republics of Central Asia, specifically Turkmenistan, which currently provides an enormous amount of energy to China. Relations between the countries, which have become contentious at times in recent years, could then be stabilized against the backdrop of cooperation on energy pricing and cooperation with the Chinese manufacturing giant.

Furthermore, the sanctions would likely strengthen the ties within the Collective Security Treaty Organization (CSTO), which would, out of necessity, need to come together in order to protect its own interests, and act as a counterweight to NATO expansion. Additionally, this would provide added leverage to Russia in its relations with the other former Soviet Republics, especially Kazakhstan, who are certainly candidates for Western-sponsored destabilization.

Finally, Russia's military cooperation around the world would undoubtedly improve. Recently, the Russian military made public its desire to [build naval and other military facilities](#) in Venezuela, Nicaragua, Vietnam, Cuba, the Seychelles, Singapore, and other countries. With the imposition of sanctions, Moscow would only feel more urgency to follow through with these plans, and to make the necessary concessions to the relevant countries in order to achieve this. Unquestionably, such moves would tremendously alter Russia's geopolitical and strategic position in the world.

If the US and EU follow through on their threats of sanctions and other punitive measures, it will at the very least have tremendous negative effects on the global economy. However, should the West, blinded by its hubris, think such sanctions will bring Russia to its knees, they have grossly miscalculated. Rather than punishing Russia, these actions will push Moscow even further down the road to true strategic independence from the West. Perhaps this

could also lead to the creation of a true multi-polar world. Were that to happen, those interested in peace and stability would rightly rejoice.

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